

***SAMPLE EXAM#1***  
**ONE POINT QUESTIONS**

1. A financial decision which results in an increase in net income is necessarily consistent with the firm's objective of maximizing its stock price.
  - a. True
  - b. False
  - c. Unable to say without more information
  
2. In a competitive marketplace, if managers deviate too far from making decisions that are consistent with stockholder wealth maximization, they risk being disciplined by the market. Part of this discipline involves the threat of being taken over by groups who are more aligned with stockholder interests.
  - a. True
  - b. False
  - c. Irrelevant, because managers can always manipulate figures to show that they are maximizing shareholder interests while in reality, they are doing no such thing.
  
3. Which of the following is not one of the things that causes a corporation to have a significant advantage over a partnership or a proprietorship?
  - a. Limited liability.
  - b. Ease of transfer of ownership interest.
  - c. Unlimited life.
  - d. Elimination of double taxation.
  - e. Ability to retain earnings and thus convert income from personal income to capital gains.
  
4. If the Federal Reserve sells \$50 billion of short-term U.S. Treasury securities to the public, other things held constant, what will this tend to do to short-term security prices and interest rates?
  - a. Prices and interest rates will both rise.
  - b. Prices will rise and interest rates will decline.
  - c. Prices and interest rates will both decline.
  - d. Prices will decline and interest rates will rise.
  - e. There will be no changes in either prices or interest rates.

5. You are given the following data:

$k^*$  = real risk-free rate = 4%

Constant inflation premium = 7%

Maturity risk premium = 1%

Default risk premium for AAA bonds = 3%

Liquidity premium for long-term T-bonds = 2%

Assume that a highly liquid market does not exist for long-term T-bonds, and the expected rate of inflation is a constant. Given these conditions, the nominal risk-free rate for T-bills is \_\_\_\_\_, and the rate on long-term Treasury bonds is \_\_\_\_\_.

- a. 4%; 14%
- b. 4%; 15%
- c. 11%; 14%
- d. 11%; 15%
- e. 11%; 17%

6. Balance sheet assets

- I. always have a value equal to total liabilities minus shareholder's equity
- II. are listed in order of increasing liquidity
- III. represent items acquired with the use of liabilities and equity

- a. I only
- b. II and III only
- c. III only
- d. I and II only
- e. I, II and III

7. An increase in the financial leverage of a firm as a result of an increase in outstanding debt \_\_\_\_\_ the potential reward to stockholders while \_\_\_\_\_ the risk of financial distress or bankruptcy.

- a. decreases; decreasing
- b. increases; increasing
- c. increases; decreasing
- d. decreases; increasing
- e. does not affect; increasing

8. Assets are listed on the balance sheet in

- a. order of importance to the firm
- b. order of increasing size
- c. order of decreasing liquidity
- d. no particular order
- e. order of preference in bankruptcy

9. Intangible assets \_\_\_\_\_

- a. are generally considered very liquid
- b. are classified on the balance sheet just before accounts receivable
- c. include such things as patents
- d. include any item that exists physically
- e. are generally very valuable

10. Which of the following is a use of cash?

- a. An increase in short-term loans
- b. An increase in accounts payable
- c. Dividends paid
- d. The sale of fixed assets
- e. The sale of new bonds

11. You are planning to save your Christmas bonuses from work and are comparing savings accounts. Account A compounds semiannually while Account B compounds monthly. If both accounts have the same effective annual rate of interest and you place only the bonuses in the account, you should

- a. choose Account A because it has a higher APR
- b. choose Account B because it has a higher APR
- c. choose Account B because it is compounded more often
- d. choose Account A because you will pay less in taxes
- e. choose either since you would be indifferent between the two

12. Which of the following is a true statement?

- I. All else equal, the value of a perpetual bond will remain unchanged from one year to the next, unless market interest rates change
  - II. All else equal, bond prices and coupon rates are inversely related
  - III. All else equal, given two bonds identical but for coupon, the market price of the lower coupon bond will change more (in percentage terms) than that of the higher coupon bond, for a given change in market interest rates
- a. I only
  - b. I and II only
  - c. I and III only
  - d. II and III only
  - e. I, II, and III

13. All else equal, the market value of a corporate bond is always inversely related to its

- I. time to maturity
  - II. coupon rate
  - III. yield-to-maturity
- a. I only
  - b. II only
  - c. III only
  - d. I and III only
  - e. I, II and III

14. A \_\_\_\_\_ - is sometimes referred to as a market maker.

- a. broker
- b. dealer
- c. member
- d. floor trader
- e. specialist

## THREE-POINT QUESTIONS

1. Fresh out of college, you are negotiating with your prospective new employer. They offer you a signing bonus of \$2,000,000 or a lump sum payment of \$2,500,000 at the end of three years from now. If you can earn 7% on invested funds, which of the following is true?
  - a. Take the signing bonus because it has the lower present value
  - b. Take the signing bonus because it has the higher future value
  - c. Take the lump sum because it has the higher present value
  - d. Take the lump sum because it has the lower future value
  - e. Based on these numbers, you are indifferent between the two
  
2. All County Insurance, Inc. promises to pay Ted \$1 million on his 65<sup>th</sup> birthday in return for a one-time payment of \$75,000 today. (Ted just turned 25.) At what rate of interest would Ted be indifferent between accepting the company's offer and investing the premium on his own?
  - a. 2.45%
  - b. 5.5%
  - c. 6.1%
  - d. 6.7%
  - e. 7.2%
  
3. Fast Eddie's Used Cars will sell you a 1986 Ford Escort for \$3,000 with no money down. You agree to make weekly payments for 2 years, beginning one week after you buy the car. The stated rate on the loan is 26%. How much is each payment?
  - a. \$32.96
  - b. \$37.06
  - c. \$38.19
  - d. \$45.90
  - e. \$69.65

4. You are considering an investment with a quoted return of 10% per year. If interest is compounded daily, what is the effective return on this investment?

- a. 1.11%
- b. 10.00%
- c. 10.25%
- d. 10.47%
- e. 10.52%

5. When you were born, your dear old AuntMinnie promised to deposit \$1,000 into a savings account bearing a 5% compounded annual rate on each birthday, beginning with your first. You have just turned 22 and want the dough, however, it turns out that dear old (forgetful) AuntMinnie made no deposits on your fifth and eleventh birthdays. How much is in the account right now?

- a. \$31,967
- b. \$34,503
- c. \$43,888
- d. \$47,983
- e. \$51,889

6. George bought an investment one year ago and just calculated his return on investment. He found that his purchasing power has increased by 15% as a result of his investment. If inflation over the period was 4%, his

- a. real return on investment is more than 15%
- b. nominal return on investment is more than 15%
- c. nominal return on investment is less than 11%
- d. real return on investment is equal to 4%
- e. ability to purchase goods has declined over the past year

7. The bonds of Microhard, Inc. carry a 10% annual coupon, have a \$1,000 face value, and mature in 4 years. Bonds of equivalent risk yield 7%. The market value of Microhard's bonds should be

- a. \$1,011.20
- b. \$1,087.25
- c. \$1,095.66
- d. \$1,101.62
- e. \$1,160.25

8.		Bond X	Bond Y
Face Value	\$1,000	\$1,000	
Semi-annual Coupon	\$50		\$45
Price		\$885.30	\$827.95

What does the above information suggest about the yield-to-maturity on these bonds?

- I. If there are ten years till maturity, the yields on the bonds are the same
  - II. If there are less than ten years till maturity, the yield on X must be greater than the yield on Y
  - III. If there are less than ten years till maturity, the yield on X must be less than the yield on Y
- a. I only
  - b. II only
  - c. III only
  - d. I and II only
  - e. I and III only

9. You can buy a stock for \$30.00 per share and can choose one of the following dividend payment schemes. If the first year's dividend growth rate is 5%, which should you choose to maximize your wealth?

- a. Dividends will grow at a decreasing rate
- b. Dividends will grow by the same dollar amount each year
- c. Dividends will grow at a constant rate
- d. Dividends will grow at an increasing rate. Dividends will grow by 5% for the first three years and 6% thereafter

10. A firm's stock has a required return of 10%. The stock's dividend yield is 6%. What is the dividend the firm just paid if the current stock price is \$40?

- a. \$2.18
- b. \$2.31
- c. \$2.50
- d. \$2.87
- e. \$3.60